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INTELLIGENCE HIGHLIGHTS--WEEK OF 11 MAY - 17 MAY 1948 53

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SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

The North Korean electric power cut-off of 14 May will have an embarrassing, although not crippling, effect upon South Korea. The Soviet-controlled North Koreans have the capability of aggravating this situation by cutting off water supplies across the border. Future moves affecting power and water supply will continue to be guided by the Soviet objective of forcing US withdrawal from Korea.

In China, opposition to Chiang Kai-shek is increasing at a time when the National Government faces mounting military efforts by the Chinese Communists and growing economic deterioration. Chiang shows no disposition to take effective measures, and apparently is trying to counter his opposition by reliance upon old, trusted, but incompetent, political figures.

The Philippine Government is currently attempting to reach a political settlement with dissident groups; if successful, such attempts would materially increase stability in the Philippines.

A new anti-Philippine movement, led by high Army and Navy officers, is reportedly developing in Siam, but is not yet believed powerful enough to threaten the Government.

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- (1) An asterisk (*) -- To indicate that all or part of an item is based solely upon information from State's "S/S distribution" series.
- (2) "A", "B", or "C" -- Importance, in B/FE's opinion, of the item, with "A" representing the most important ones.

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Sale of Japanese rolling stock to Europe discouraged

The US Political Adviser in Tokyo has replied to the State Department's request for his comments on the possibility of Japanese rolling stock manufacturing capacity being used for European needs if Japan is capable of producing equipment for a standard gauge railroad (See B/FE Weekly of 4 - 10 May.) The Adviser states that Japan has the capacity to produce such equipment, but that it is not feasible for Japan to export any appreciable quantities during the next fifteen months because (1) Japan itself is currently very short of rolling stock at a time when it faces heavy transportation needs, and (2) during the next year, Japan will be unable to produce more than about one-half of the 10,000 freight cars actually needed domestically because of its lack of raw materials, such as pig iron or iron ore, manganese ore, magnesia clinker, coal, and possibly some types of lumber. In addition, Japan has a tentative commitment to the USSR for 310 freight cars.

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JAPAN

Outcast leader possible Communist convert. MATSUMOTO Jiichiro, widely recognized as the leader of the Eta (outcasts), and vice-president of the House of Councillors, is reportedly becoming a Japanese Communist Party (JCP) convert. Although the new Constitution legally removes the discrimination to which the Eta have been subject for centuries and they now have political equality, it would be naive to expect the age-old social and economic discrimination to have been completely discarded. MATSUMOTO, himself an outcast for the past two and a half decades, has been the recognized champion of the downtrodden Eta in their struggles for equality.

"B"

In the April 1947 general elections MATSUMOTO gained a seat in the Upper House as a Social Democrat and the Eta as a class voted the Social Democratic ticket. If he becomes a Communist, making a public avowal of his conversion and requesting his people to follow, most of the Eta would probably transfer their ballots to the JCP. The Japanese Government estimates Eta numbers at one million while they themselves claim three million. The JCP polled approximately one million votes in the April 1947 general election and, since the addition of the Eta to their ranks would be invaluable, the JCP has reportedly been making consistent efforts to convert MATSUMOTO to their doctrines.

KOREA

Loss of North Korean power is causing hardship but not chaos in South Korea at present. The stoppage will not immediately impair operation of South Korea's most essential services, but a sharp decrease in already low industrial production will be inevitable. Plans are in effect which will permit continuance of essential services and industries through August but these involve partial reliance upon stand-by thermal plants previously idle because of high operational expenses and lack of an adequate quantity and quality of coal. Moreover, the stepping-up of hydro-electric generation involved in these plans can be effected only during the summer months when rain will give the additional necessary water supply. A severe rationing program and careful use of limited coal stocks will permit South Korea to supply 60% of its current needs of approximately 100,000 kw. in June. After July bituminous coal imports of 20,000 metric tons per month will be required to maintain the production of 60% of requirements. The anticipated summer rains will raise the figure to 80-90% during July and August. It is to be noted, however, that Chong Pong, a hydro-electric plant now producing about 18,000 kw. and which is now undergoing repairs in order to step-up its generation, cannot be depended upon in the present emergency since it uses water from north of the 38th parallel which can be turned off by the North Koreans. North Korea also has the capability of cutting off water used for irrigation purposes in South Korea with a resultant adverse effect on South Korean agricultural areas adjacent to the 38th parallel.

"A"

There is nothing to compel the Soviet authorities to restore the power supply to South Korea. However, propaganda considerations could induce them to make the cut-off only temporary. If the power supply is

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restored, therefore, it will probably be accompanied by repeated explanations that the cut-off was directed only against the US occupation authorities and that sympathy with the plight of their suffering countrymen prompted the North Koreans to reverse their decision. It is apparent that the Kremlin is determined to take maximum advantage of the power situation as part of its presently-indicated campaign to assure that US withdrawal from Korea will be accomplished under the most embarrassing and chaotic circumstances. The path will then be open for rapid North Korean conquest and consolidation of the South. Adoption of an "all-Korean" Constitution by the North Korean People's Council on 29 April marked the completion of preparations for eventual annexation of South Korea. The presence of US occupation forces is now the only factor frustrating implementation of Soviet plans to dominate all of Korea.

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CHINAIncreasing Opposition to Chiang Kai-shek

There seems to be no prospect that Chiang Kai-shek will introduce any "A" reforms that might improve China's present critical situation and regain popular support for the National Government. The complexion of the National Government appears to be unchanged by the governmental reorganization now taking place. Rather than introducing into the Government liberal personalities inclined toward positive action, Chiang Kai-shek is apparently attempting to balance the opposition voiced through Li Tsung-jen's election to the Vice-Presidency by maintaining in the top government positions political figures upon whom he has relied in the past, despite their ineffective records.

The position of Vice-President has little constitutional power and Chiang will probably try to keep Li Tsung-jen from assuming any authority. Li, however, is following his progressive political campaign by the formulation of a reform program. Li's political advisor has indicated that if Chiang refuses to accept the plan, Li will force the Generalissimo into the background and take over the leadership of the Government. Li's movement appears to be gathering strength and a program for positive reform would undoubtedly command popular support.

Marshal Li Chi-shen's Kuomintang Revolutionary Committee now operating in Hong Kong also gives indications of being an effective source of opposition. This group is reported to have definite plans for overthrowing the Generalissimo and negotiating with the Communists for peace. Marshal Li reasons that any government responsible for ending civil strife would be assured immense popular support and that peace is necessary to stabilize the country and prevent the spread of Communism. It is rumored that Li Chi-shen's group is associated with the movement centering around Li Tsung-jen. Their combined forces might be able to force Chiang's withdrawal, which they both desire, since, as long as Chiang shows no indications of taking effective measures to handle the present crisis, the demand for new leadership will increase. However, in any political upheaval the process of disintegration will probably be accelerated at first and the initial advantages will therefore accrue to the Chinese Communists.

The tenor of Chiang Kai-shek's recent appointments is indicated in the naming of an old reliable, Marshal Ku Chu-tung, to be Chief of Staff, succeeding General Chen Cheng. Marshal Ku, who has been Chief of the Army Ground Forces and concurrently commander of the Advance Headquarters at Haichou, is considered one of the most incompetent generals in the Nationalist Army. General Yu Han-mou, another of the Generalissimo's trusted but hardly qualified reliables, succeeds Ku.

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The return of General Roschin, new Soviet Ambassador to China, has aroused speculation as to whether the USSR will now adopt a more positive policy than hitherto in Chinese affairs. There has been no Soviet Ambassador at Nanking since last June. General Roschin may renew talks with Chinese officials regarding a compromise settlement of the civil conflict, and it is possible that he may offer Soviet mediation. In addition it is likely that Roschin will undertake mediation of the current impasse in Sinkiang, and that this will be accepted by General Chang Chih-chung, top Chinese official in that province. No real progress has been made toward solving the deadlock in Sinkiang through the exchange of notes during the past eight months between Gen. Chang Chih-chung and the Ili Group. As minimum conditions for a resumption of negotiations, the Chinese demand return of Ili leaders to Tihwa; the Ili Group demands dismissal of Mesud Sabri as provincial Governor. Neither side will agree to the condition demanded by the other. So far, the exchange of notes has resulted only in keeping the situation open to discussion, and in forestalling resumption of large-scale warfare. Soviet mediation will probably result in further Chinese concessions to the Ili Group.

Financial Position Nationalist China. There appears to be little hope within the government of arresting the deteriorating economy in the visible future. Among factors for this growing realization are: (1) effective US aid is still months off, (2) prices are advancing much faster (almost doubled during the past month) than the note issue, (3) government revenues are said to be only 40% of expenditures, which now amount to CN \$24 trillion monthly; first half 1948 budget of CN \$96 trillion is already exceeded, and (4) the discrepancy between the "open" and black-market exchange rates is ruinous to the export trade.

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[REDACTED] has expressed [REDACTED] serious concern over the general economic and financial position of the government, and is considerably pessimistic over the US aid program in relation thereto. He said: (1) foreign exchange is completely exhausted except for working balances, and the Central Bank has been borrowing exchange from the Bank of China the past six weeks, (2) April note issue increased 40% over March, while the budgetary situation is "completely out of hand", and (3) the ineptitude, indifference, fear, and general low morale in high government circles have become much worse in the past three months.

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PHILIPPINES

Quirino Government attempts to solve law and order problem. The new "A" Quirino administration, in a dramatic effort to establish its power and prestige, has reversed the stern policy of the Roxas administration toward dissident groups. The Government is currently negotiating for the surrender of Luis Taruc, leader of the Hukbalahap, and his followers, and has prepared an amnesty proclamation which the Philippine Congress reportedly is prepared to accept. Although neither the terms of the surrender nor the provisions of the amnesty are yet known and although serious obstacles could easily develop, the negotiations thus far represent a significant achievement. If a surrender is negotiated which will effectively reduce the number of firearms in circulation and if a reasonable amnesty is issued, substantial progress toward stability in the Philippines can be anticipated.

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SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES

Economic Importance of Manchuria

Manchuria is almost unique among the areas of the Asiatic mainland in that, under existing conditions of technology and population density, it possesses a capacity to produce more than it consumes for current purposes -- that is, a capacity to create capital. In addition, Manchuria possesses an industrial plant which, despite Soviet removals, war destruction and deterioration, is valued at approximately US \$2.5 billion. Under favorable circumstances this plant could be increased to US \$6.5 billion within a decade, or four times as large as the total industrial plant in China proper in 1936, and half the size of Japan's 1936 industrial plant.

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Manchuria is of little direct economic importance to the US in terms of future trade possibilities. However, in terms of the future balance of power in northeast Asia, Manchuria is of somewhat greater importance to the US. Given a friendly China in control of Manchuria, US capital could utilize the economic potential of that area to develop China into an industrial power. On the other hand, Communist control of Manchuria would complicate the problem of economic recovery in Japan and provide the USSR with a trade weapon that could be used for political purposes in Asia. In addition, the USSR would acquire Manchuria's large agricultural surpluses, useful to the development of Eastern Siberia. It is considered unlikely, however, that the USSR could or would in the short-term future realize upon the Manchurian potential for industrial development.

(The Economic Importance of Manchuria to the United States.
Dept. of State, OIR Report No. 4160,
23 January 1948. CONFIDENTIAL -US Officials
only. Distributed in April 1948.)

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